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No. 74-1471

In the

Supreme Court of the United States

OCTOBER TERM, 1974

TSC INDUSTRIES, INC., a Delaware corporation, NATIONAL INDUSTRIES, INC., a Kentucky corporation, and TSC INDUSTRIES, INC. (formerly named NII, INC., and being the successor to the business, assets and corporate name of said TSC INDUSTRIES, INC.), NORTHWAY, INC., a Delaware corporation,

Petitioners,

vs.

NORTHWAY, INC., a Delaware corporation,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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OPINIONS BELOW

The opinion of the Court of Appeals is reported at 512 F.2d 324.

Otherwise, Opinions Below, Jurisdiction, and Statutes and Rules Involved are as stated in the Petition.

QUESTION PRESENTED FOR REVIEW

The sole question presented and available for review by this Court would be:

Whether the evidence in the record below, establishing without genuine controversy the omission of numerous admitted and uncontroverted facts from the proxy statement, evaluated in the light of the contents of the proxy statement and the governing regulatory policies, was sufficient to establish a violation of Rule 14a-9 as adjudicated by the entry of partial summary judgment on the issue of liability?

STATEMENT OF THE CASE

The facts and proceedings below are fully and fairly summarized in the opinion of the Court of Appeals (but not in the Petition), appended to the Petition at pages A1-A30, and reported at 512 F.2d 324.

REASONS WHY THE WRIT SHOULD BE DENIED

A. THE CASE TURNS WHOLLY ON ITS FACTS AND PRESENTS NO IMPORTANT QUESTIONS.

1. The Judgment Rests on Multiple Independent Grounds Founded on Specific Factual Omissions from this Particular Proxy Statement.

This case is not worthy of this Court's time and attention. The decision below turns wholly upon the facts. The judgment below rests solidly upon multiple grounds, each independent, separate, and adequate in itself to support the entry of partial summary judgment on the issue of liability. The Court of Appeals, in an opinion devoted heavily to an exposition of the admitted and uncontroverted facts, held without doubt or equivocation that the proxy

statement violated the disclosure Rules with at least four patently misleading omissions. They can be briefly summarized.

Prior reports of control. The proxy statement prominently presented the urgings of the TSC board of directors, advising its shareholders to vote for approval of the takeover by National. Yet not a single mention was made of the fact that a series of three official reports had been filed with the SEC by both TSC and National, only a matter of months before the proxy statement was mailed, in order to report that National may be deemed to be the parent of TSC and hence in control of the corporation. As the court below held, these facts, revealing that "both National and TSC thought it necessary to inform the Securities Exchange Commission that National could be deemed to be in control of TSC" . . . "were persuasive indicators that . . . National thus 'sat on both sides of the bargaining table' in setting the terms of the exchange" and their nondisclosure was therefore "materially misleading within the meaning of §14(a) . . . ." Pet. A13-14; 512 F2d, 333.

Key executive positions. The proxy statement presented the advice of TSC's management, counseling the shareholders to vote approval, without disclosing that National's president, Stanley Yarmuth, had been installed as Chairman of the Board of TSC, and had thereby become its Chief Executive empowered under its by-laws to supervise and control all TSC business. Nor was there any disclosure of the fact that National's executive vice president, Charles Simonelli, had been installed as Chairman of TSC's Executive Committee, with National's president as one of the Committee members. The judges below unanimously agreed "that the failure to include these facts was misleading since TSC stockholders were

relying on the TSC board of directors to negotiate on their behalf for the best possible rate of exchange with National." Pet A 13; 512 F. 2d, 333.

Undisclosed stock purchases. The exchange offered to the TSC shareholders gave them a package consisting of warrants to buy National common and of preferred shares convertible into National common. The market prices of National common in recent years were displayed, and emphasized by repeated references, in the advice to the shareholders, to "recent market prices" and "current market values represented by the securities being offered . . . ." But crucial facts bearing on these market prices were not revealed. During the last two year period of the market-price list, National and Madison Fund Inc., a large mutual fund, had purchased some 260,000 shares of National common. This purchase program amounted to some 8.5% of all market transactions in the stock in the nine months preceding the takeover. In addition, Madison Fund also purchased $2 million in National debentures convertible to common. Madison Fund's president, Edward Merkle, was carried on the National payroll at $12,000 per year for "being available" to National at least one day per month, and National's board chairman, Bernard Barnett, was a Madison director. Because shareholders "must be informed of circumstances which tend to indicate that the current selling price of the common stock involved may be affected by apparent market manipulations", the court found that these omissions "also violated Rule 14a-9 as a matter of law." Pet A 19; 512 F.2d, 336.

Market price of warrants. The proxy statement recited that the firm of Hornblower & Weeks-Hemphill, Noyes had rendered a favorable opinion regarding the fairness of the transaction to TSC shareholders, based in part on "the

substantial premium over current market values represented by the securities being offered to TSC stockholders." Prices and exchange ratios were supplied, inviting the shareholder to calculate his own substantial premium. The shareholders were *not* told that the Hornblower firm had also rendered an opinion predicting that the offered warrants, when issued, would sell at $3.50 rather than at the $5.25 price shown in the proxy statement. This disclosure would have reduced the apparent "substantial premium" by 89% for TSC common and 54% for TSC preferred. The Court of Appeals' common-sense conclusion is simple and succinct; "The materiality of the omission is obvious." Pet. A 18; 512 F. 2d, 335

Lending weight to these holdings of the court below, the SEC, as the responsible and expert agency in the field, independently reached the same conclusions, and advocated this judgment in its brief as *amicus curiae* in that court.

2. A Review of the Sufficiency of the Facts Would Serve No Useful Purpose.

The weight of these omissions, singly and in combination, is the sole issue open for review and the only real question that can be tendered to this Court by a petition for certiorari. The Court does not sit to review evidence, and does not write opinions to discuss specific facts, unique to the case at hand. A decision by this Court, analyzing the sufficiency of the voluminous evidence, could have no impact beyond the limits of this specific and isolated case.

There is no real question here of what the law is. The Petition makes a labored but vain attempt to concoct a legal question of the definition of materiality, based on a misinterpretation of the Court of Appeals' opinion, as we submit below, pages 7-9. Against this attempt, the decision below stands as a straightforward application of the standards laid down by this Court in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970), and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972).

3. Under Any Conceivable Test, Materiality Is Clearly Established by the Admitted Facts.

Even if some verbal fault could be charged to the lower court's restatement of this Court's test of materiality (which it cannot), and even if some difference in definition could be found which was not purely hypothetical, abstract, and lacking any capacity to decide real cases (which it cannot), such an issue would be irrelevant to the decision of this particular, concrete case. Under any plausible standard of materiality, the misstatements and omissions established in this record are clearly material. They concern the two most critical factors in the shareholder's decision: (1) a conflict of interest tainting the advice given by his board of directors and management, and (2) the unreliability of the market prices for the securities offered to him in the exchange.

Petitioners necessarily concede that "in many cases misstatements or omissions may be so clearly material that there is no need nor occasion to focus on the standard of materiality." Pet. 10. If any misleading omission can ever be ruled to be material as a matter of law in a proper case, then this is that case. Thus the Petition, at best, is an invitation to useless *obiter dictum*.

4. Whatever the Standard, the Result Reached Below is Compelled by this Court's Mills Decision.

The irrelevance of the Questions Presented to the result in this case is emphatically demonstrated by a comparison of the facts here with the facts and result in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970). The match is complete. There, as here, a partial summary judgment on liability was entered upon a showing that needed votes for a merger had been obtained through a proxy statement offering the favorable advice of the target's board of directors without disclosing a control relationship, involving a conflict of interest, previously reported to the SEC. This Court unanimously held that liability is established by such a showing, and chose not to disturb the lower courts' ruling that the omissions were material as a matter of law, without the necessity of an impractical trial on "the probabilities that the merger would have received a sufficient vote even if the proxy statement had not been misleading." 396 U.S., 380. The identity of facts here requires an identical result, with no need for inquiry into the reasoning of the court below. It is not the function of review to police the language of lower courts when the right result has been reached.

B. THE QUESTIONS PRESENTED IN THE PETITION HAVE NO BASIS IN THE RECORD.

1. The Opinion Below Announces No New or Novel Test of Materiality.

The Petition is based wholly upon a misreading of the opinion below and a misinterpretation of the Court of Appeals decision. That court did *not* say that materiality "requires only a showing of relevancy and possible importance to 'some few stockholders,'" as petitioners urge in

their first Question Presented (Pet. 2). On the contrary, the Court of Appeals explicitly "concluded that the proper test of materiality is whether the omitted fact is 'of such a character that it might have been considered important by a reasonable shareholder who was in the process of determining how to vote.'" Pet. A11-12; 512 F.2d, 332. This test is directly quoted from this Court's decision in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970) and as reiterated and reconfirmed in *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 154 (1972).

Two corollaries are implicit in this Court's test. First, since the *reasonable* shareholder controls, it follows that materiality exists despite the fact that *some* shareholders may regard the fact as irrelevant or unimportant, so long as the average, typical, reasonable shareholder might consider it important. Thus, the Court of Appeals correctly observed that this Court's test will "reach facts which may be relevant for some, but not for others." Pet. A9; 512 F.2d, 331.

The second corollary is implicit in the word "important" in this Court's test. The omitted fact need not be of such overwhelming significance to the reasonable shareholder that it will necessarily reverse his vote; it is enough that he might consider it *important*, whether or not it is *determinative* of his vote. Accordingly, the court below was merely restating the obvious in observing that a fact is nonetheless material although it might not be determinative of the votes of most shareholders, and even though only "for some few stockholders these same facts could be determinative." Pet A9; 512 F.2d 330. This Court made the same observation in a footnote elaboration of its materiality test in *Mills* itself, pointing out that importance is enough, regardless of whether a reasonable stock-

holder would still have voted the same way without the nondisclosure:

> "Thus, the failure to make such a disclosure was found to be a material defect 'as a matter of law,' thwarting the informed decision at which the statute aims, *regardless of whether the terms of the merger were such that a reasonable stockholder would have approved the transaction* after more careful analysis." 396 U.S., 384 (emphasis added).

The Petition seizes upon two phrases wrenched from their context, where they served merely to restate the obvious and inherent corollaries to this Court's test of importance to a reasonable shareholder. Isolating "some few stockholders" and "relevant for some, but not for others," the Petition escalates them into a supposed "new" and "novel" test of materiality, offered as the principal Question Presented for review by this Court. This pretended Question evaporates with a fair reading of the Court of Appeals opinion.

2. Petitioners' "Propensity" Test Finds No Support in Mills and Contravenes its Holding.

The Petition also fails in its effort to devise some question of law for review by manufacturing two separate and conflicting tests of materiality with the catch phrases "might have" and "significant propensity." The phrases are taken from consecutive sentences in Mr. Justice Harlan's opinion in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S., at 384, and the argument assumes that he was at once announcing two conflicting and contradictory tests. His words, fully and fairly read, put that assumption to rest. Materiality, he said, "embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was

in the process of deciding how to vote. *This* requirement that the defect have a significant *propensity* to affect the voting process . . ." 396 U.S., 384 (emphasis added to "This") Thus the catch phrases are merely synonyms, not contradictory standards, and the "significant propensity" is itself established by the "might have been considered important" test.

Mr. Justice Harlan, a consummate practitioner of the careful lawyer's art, was not indulging in loose talk. He was addressing directly the question before him: What effect on the voting process must be shown to establish liability for misstatements or omissions in a proxy statement? His answer is plain. The "significant propensity" required is established when the defect "might have been considered important by a reasonable shareholder." There is no need to engage in "the impracticalities of determining how many votes were affected" nor to require "proof of whether the defect actually had a decisive effect on the voting." 396 U.S., 385.

In this light, petitioners' "significant propensity" test is revealed as a subtle distortion of Justice Harlan's phrase. Through repetition out of context, the words are loaded with a connotation requiring appraisal of the probabilities that the outcome of the voting process would have been reversed. Petitioners would invert this Court's test to require instead, as they state, "that the omission or misstatement is likely to alter the outcome of shareholder voting", (Pet. 13), and to require "a trial on the issue of materiality" so misdefined. Pet. 16. Just such a trial "of the probabilities that the merger would have received a sufficient vote even if the proxy statement had not been misleading" (396 U.S., 380), had been ordered by the appellate court in *Mills*. This Court reversed.

In the guise of materiality, rather than causation, petitioners' "propensity" test demands a factual finding on the probability of a different outcome in the overall shareholder vote, in direct contravention of *Mills*. It is this distorted "propensity" test, advanced by petitioners, which the Court of Appeals rejects, not Justice Harlan's propensity which inheres in an omission that might have been considered important by a reasonable shareholder.

3. The Supposed Conflict Among the Circuits Is Nonexistent.

Petitioners' supposed conflict among the circuits disappears with the revelation of their distortion of "significant propensity." The court below was not disagreeing with the Second Circuit in its discussion of the "propensity" test, but was rather rejecting petitioners' unique argument. Neither the Second Circuit nor any other has accepted petitioners' test, and no conflict exists.

Judge Friendly in the *Gerstle* case offered not the slightest hint that he would require a trial to determine whether the misstatement was "likely to alter the outcome of shareholder voting" (Pet. 13), whether viewed prospectively or retrospectively, after the fact. On the contrary, he sustained the entry of summary judgment for plaintiff on the issue of liability, on the ground that the omission was material as a matter of law. *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2nd Cir. 1973).

The only difference between Judge Friendly's views and the views of Judge Swygert in the opinion below concerns a matter of verbal preference: Whether the materiality test should be expressed with "might", in accordance with this Court's phrasing in *Mills* and *Affiliated Ute Citizens*, or with "would", as Judge Friendly prefers. The differ-

ence, if any, is purely a matter of emphasis. Judge Swygert prefers "might" in order to emphasize that there is no need for evidence showing an actual impact on the vote of the shareholders as a whole, as *Mills* held, reversing the decision of a panel on which he sat. Pet. A10 n. 13; 512 F.2d, 331 n. 13. Judge Friendly prefers "would" to emphasize that the omission must not be trivial, (478 F.2d 1302), again as *Mills* held. But neither Circuit emphasized one aspect to the exclusion of the other, and of course Judge Swygert put "trivial" omissions aside.

The root question of materiality is whether the omitted fact is important enough that it ought to be disclosed to investors. Congress aimed at the solicitation, not the merger. Whether the proxy statement made the full and fair disclosure required by congressional policy does not depend upon the probability that the merger would have failed without the omission, nor is deceitful solicitation immunized by the probability that truth would also have succeeded. If the proxy solicitation (not the specific omission) produced votes essential to merger, there is no need to inquire further. This is the point of *Mills,* missed by petitioners.

Thus the issue is not a matter of factual probability or prediction of votes; "might" and "would" in this context do not describe a factual burden of proving what would or did actually happen. Rather, the words are used to express the requirement that the omitted fact most be of such a character as to be important to a reasonable shareholder. The question is not factual probability but permissibility within the limits of ordinary reason. It is in this sense that the degree of relevancy is the appropriate test of materiality. See opinion below, Pet. A10; 512 F.2d, 331. For this specific purpose, any possible difference between the verbs "might" and "would" is gossa-

mer, too ethereal, and hypothetical to carry any consequence in the decision of concrete cases.

The Second Circuit in *Gerstle,* under its "would" preference, found some omissions to be material as a matter of law, and others not. The Seventh Circuit below, preferring "might", also found some omissions material, and one not. There is no foundation for believing that the result in either case would have been affected in the slightest degree by a change in the tense, voice, or mood of the verb. Word choices that have no practical capacity to decide concrete cases are not the proper business of this Court. It would be shoveling smoke, in Learned Hand's phrase, to engage in this abstract and purely grammarian debate.

C. OTHER GROUNDS, NOT RELIED ON BY THE COURT BELOW, WOULD REQUIRE AFFIRMANCE OF THE JUDGMENT.

1. The Particular Facts Omitted Are Material as a Matter of Law Since They Are Singled Out by the Securities Laws as Critically Important.

A decision by this Court, choosing between "would" and "might", would have no decisional power in this case or any other. Beyond the reach of semantics, the judgment below is solidly grounded on facts, admitted, established, and plentiful. And beyond the four corners of that opinion, there are still other grounds which would compel affirmance.

Materiality under the securities laws does not depend exclusively upon the prevailing opinions of reasonable shareholders or their expectations in a vacuum. Many may not know what it is they need to know, and their

expectations are fed by the statutory scheme. Thus whether a fact is material as a matter of law may be properly determined by the circumstance that the law, as laid down by Congress and the SEC, has singled out that fact for special treatment and specific attention.

Here Congress has concluded that control of a corporation is a matter of such overwhelming importance to the investing public as to require immediate and special reports, under criminal penalties, whenever there is a change in control, by both the person acquiring control and by the issuer of the the affected security. To harmonize and effectuate the statutory scheme as a whole, any event which is so important as to trigger such special reports under §13 of the 1934 Act must be viewed under §14 as material as a matter of law.

Under the same principle, petitioners' nondisclosures of the major purchases of National common by the issuer and an affiliated investment fund are material as a matter of law, since Congress and the SEC have singled out such purchases as the subject of special prohibitions and regulations. See Rule 10b-6(b), and §9(b), Securities Exchange Act of 1934, 15 U.S.C. §78(i) (1934). And here the SEC found nondisclosure of such purchases by the Fund to be important enough to be the subject of suspension proceedings against its president. *In re Merkle,* SEC Inv. Co. Release No. 7280 (July 19, 1972).

Whatever uncertainties may confront the author of a proxy statement in other situations, he could have no room for doubt about what should be included in this instance. Both corporations issuing the joint statement had filed special reports only months earlier, to report a change in control. National was fully aware of its

stock purchases, and of those made by its employee also serving as president of Madison Fund. Any decision by this Court, refining the guidelines of its materiality test, would be irrelevant to this case and others where the regulatory scheme as a whole makes clear beyond peradventure the importance and materiality of the fact.

2. Affirmance Would Be Required on Alternative Grounds, Not Adopted Below, Involving No Element of Materiality.

In any event, the whole question of materiality is completely irrelevant under either of two alternative and adequate grounds of decision, not adopted by the court below. First, under Delaware law, as the opinion below intimates but declines to decide in view of the adequacy of other grounds, the board of directors' vote by less than a majority was insufficient to authorize any vote by the shareholders. It follows that *any* solicitation of proxies was misleading and deceitful, regardless of the contents of the proxy statement. Second, the SEC has forbidden the use of a proxy statement which does not directly state any change in control which has occurred, as petitioners had here reported to the SEC. This nondisclosure constituted a direct violation of Rule 14a-3 (Pet, A5, n. 8; 512 F.2d, 329 n. 8), which embodies no requirement of materiality. If certiorari were granted, the lower court's erroneous failure to add this ground of decision to the many others it adopted would suffice for affirmance with no need for consideration of any question of materiality as tendered by the Petition. In short, the Questions Presented are not necessary to decision and thus are not squarely raised by this case.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

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